

Internal Revenue Service

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Washington, DC 20224

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Person To Contact:

, ID No

Telephone Number:

Refer Reply To:

CC:PSI:B01

PLR-120015-13

Date:

November 14, 2013

LEGEND

X =

A =

B =

Trust 1 =

Trust 2 =

Trust 3 =

Trust 4 =

Trust 5 =

Trust 6 =

Trust 7 =

Trust 8 =

Trust 9 =

Trust 10 =

Trust 11 =

Trust 12 =

Trust 13 =

Trust 14 =

Trust 15 =

Trust 16 =

Trust 17 =

Trust 18 =

Trust 19 =

Trust 20 =

Trust 21 =

Trust 22 =

Trust 23 =

Trust 24 =

Date 1 =

Date 2=

Date 3=

Date 4=

Date 5=

Date 6=

Year 1=

Year 2=

Year 3=

State =

Dear :

This responds to a letter signed April 25, 2013, and subsequent information, submitted on behalf of X by X's authorized representative, requesting relief under § 1362(f) of the Internal Revenue Code (the Code).

FACTS

According to the information submitted and representations within, X was incorporated on Date 1, under the laws of State. Effective Date 2, X elected to be taxed as an S corporation. Further, on Date 2, the shareholders of X included Trust 1, Trust 2, Trust 3, and Trust 4.

Effective Date 3, A and B transferred X shares to Trust 5, Trust 6, Trust 7, Trust 8, Trust 9 and Trust 10. Trust 1, Trust 2, Trust 3, Trust 4, Trust 5, Trust 6, Trust 7, Trust 8, Trust 9 and Trust 10 are collectively referred to as the Trusts. The Trusts were not eligible shareholders of X. The terms of the trust agreements for the Trusts failed to satisfy the requirements for a Qualified Subchapter S Trust (QSST) under § 1361(d)(3)(A)(iv) and therefore the Trusts were not eligible shareholders of X. Also, Trust 1, Trust 2, Trust 3, and Trust 4 failed to satisfy the QSST requirements of § 1361(d)(3)(B) for Year 1 through Year 3 and Trust 5, Trust 6, Trust 7, Trust 8, Trust 9 and Trust 10 failed to file QSST elections and subsequently failed to satisfy the QSST requirements of § 1361(d)(3)(B) for Year 2 through Year 3.

Effective Date 4, the assets of each Trust including the X shares, were transferred to new Trust 11, Trust 12, Trust 13, Trust 14, Trust 15, Trust 16, Trust 17, Trust 18, Trust 19 and Trust 20, respectively, which are collectively referred to as the New Trusts. The terms of the New Trusts satisfied the requirements of § 1361(d) and timely QSST elections were filed by the beneficiaries, or guardians of minor beneficiaries, of the New Trusts.

Trust 21, Trust 22, Trust 23, and Trust 24 (collectively the GST Trusts) acquired nonvoting stock of X on Date 5. The GST Trusts were initially treated as eligible shareholders of X under § 1361(c)(2)(A)(i) but they were eligible to be treated as Electing Small Business Trusts (ESBTs). The trustees of the GST Trusts failed to file timely elections to treat the GST Trusts as ESBTs effective Date 6.

X represents that X and its shareholders have always intended for X to be an S corporation and that the failure of Trusts to qualify as eligible shareholders of X and the failure of the GST Trusts to file ESBT elections were unintentional and were not motivated by tax avoidance or retroactive tax planning. X represents that it has filed its income tax returns consistent with being treated as an S corporation and that the respective beneficiaries of the Trusts and New Trusts have reported their allocable shares of X's income consistent with the treatment of the Trusts and the New Trusts as QSSTs. Lastly, X represents that X and its shareholders agree to make any adjustments required as a condition of obtaining relief under the inadvertent termination rule as provided under § 1362(f) of the Code that may be required by the Secretary.

LAW AND ANALYSIS

Section 1361(a)(1) of the Code provides that the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(1) defines a "small business corporation" as a domestic corporation which is not an ineligible corporation and which does not (A) have more than 100 shareholders, (B) have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual, (C) have a nonresident alien as a shareholder, and (D) have more than 1 class of stock.

Section 1361(c)(2)(A)(i) provides that for purposes of § 1361(b)(1)(B), a trust may be a shareholder if all of it is treated (under subpart E of part I of subchapter J of chapter 1) as owned by an individual who is a citizen or resident of the United States.

Section 1361(c)(2)(B)(i) provides that for purposes of § 1361(b)(1), in the case of a trust described in § 1361(c)(2)(A)(i), the deemed owner shall be treated as the shareholder.

Section 1361(d)(1) provides that a QSST whose beneficiary makes an election under § 1362(d)(2) will be treated as a trust described in § 1361(c)(2)(A)(i), and the QSST's beneficiary will be treated as the owner (for purposes of § 678(a)) of that portion of the QSST's S corporation stock to which the election under § 1361(d)(2) applies. Under § 1361(d)(2)(A), a beneficiary of a QSST may elect to have § 1361(d) apply. Under § 1361(d)(2)(D), this election will be effective up to 15 days and two months before the date of the election.

Section 1361(d)(3) provides that for purposes of § 1361(d), the term "qualified subchapter S trust" means a trust (A) the terms of which require that – (i) during the life of the current income beneficiary, there shall be only 1 income beneficiary of the trust; (ii) any corpus distributed during the life of the current beneficiary may be distributed only to such beneficiary; (iii) the income interest of the current income beneficiary in the trust shall terminate on the earlier of such beneficiary's death or the termination of the trust; and (iv) upon the termination of the trust during the life of the current income beneficiary, the trust shall distribute all of its assets to that beneficiary; and (B) all of the income (within the meaning of § 643(b)) of which is distributed (or required to be distributed) currently to 1 individual who is a citizen or resident of the United States.

Section 1361(d)(4)(B) provides that if any QSST ceases to meet the requirement of § 1361(d)(3)(B), but continues to meet the requirements of § 1361(d)(3)(A), the provisions of § 1361(d) shall not apply to the trust as of the first day of the first taxable year beginning after the first taxable year for which the trust failed to meet the requirements of § 1361(d)(3)(B).

Section 1361(c)(2)(A)(v) provides that for purposes of § 1361(b)(1)(B), an ESBT is a permissible shareholder.

Section 1361(e)(1)(A) provides that, except as provided in § 1361(e)(1)(B), the term electing small business trust means any trust if (i) such trust does not have as a beneficiary any person other than (I) an individual, (II) an estate, (III) an organization described in § 170(c)(2)(5), or (V) an organization described in § 170(c)(1) which holds a contingent interest in such trust and is not a potential current beneficiary, (ii) no interest in such trust was acquired by purchase, and (iii) an election under § 131(e) applies to such trust.

Section 1361(e)(3) provides that an election under § 1361(e) shall be made by the trustee. Any such election shall apply to the taxable year of the trust for which made and subsequent taxable years of such trust unless revoked with the consent of the Secretary.

Section 1.1361-1(j)(6)(iii)(c) provides that, in the case of a QSST election, if a trust ceases to be a qualified Subpart E trust, satisfies the requirements of a QSST, and intends to become a QSST, the QSST election must be filed within the 16-day-and-2-

month period beginning on the date on which the trust ceases to be a qualified subpart E trust.

Section 1.1361-1(m)(2)(iii) provides that an ESBT election must be filed within the time requirements prescribed in paragraph (j)(6)(iii) for filing a QSST election.

Section 1.1361-1(m)(2)(ii) provides that an ESBT election statement must include: (A) the name, address, and taxpayer identification number of the trust, the potential current beneficiaries, and the S corporation in which the trust currently holds stock. If the trust includes a power described in paragraph (m)(4)(vi)(B) of this section, then the election statement must include a statement that such a power is included in the instrument, but does not need to include the name, address, or taxpayer identification number of any particular charity or any other information regarding the power; (B) an identification of the election as an ESBT election made under section 1361(e)(3); (C) the first date on which the trust owned stock in each S corporation; (D) the date on which the election is to become effective (not earlier than 15 days and two months before the date on which the election is filed); and (E) representations signed by the trustee stating that – (1) the trust meets the definitional requirements of section 1361(e)(1); and (2) all potential current beneficiaries of the trust meet the shareholder requirements of section 1361(b)(1).

Section 1.1361-1(m)(2)(iii) due date for ESBT election – the ESBT election must be filed within the time requirements prescribed in paragraph (j)(6)(iii) of this section for filing a qualified subchapter S trust (QSST) election.

Section 1362(a) provides, in part, that a small business corporation may elect to be an S corporation.

Section 1362(d)(2)(A) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the 1st day of the 1st taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation.

Section 1362(f) provides, in relevant part, that if (1) an election under § 1362(a) by any corporation was not effective for the taxable year for which made (determined without regard to § 1362(b)(2)) by reason of a failure to meet the requirements of § 1361(b); (2) the Secretary determines that the circumstances resulting in such ineffectiveness or termination were inadvertent; (3) no later than a reasonable period of time after discovery of the circumstances resulting in such ineffectiveness or termination, steps were taken so that the corporation for which the termination occurred is a small business corporation; and (4) the corporation for which the termination occurred, and each person who was a shareholder in such corporation at any time during the period specified pursuant to § 1362(f), agrees to make the adjustments (consistent with the treatment of such corporation as an S corporation) as may be required by the Secretary

with respect to such period, then, notwithstanding the circumstances resulting in such ineffectiveness or termination, such corporation shall be treated as an S corporation during the period specified by the Secretary.

Section 1.1361-1(j)(6)(ii) of the Income Tax Regulations, provides that the current income beneficiary of the trust must make the election by signing and filing with the service center with which the corporation files its income tax the applicable form or a statement including the information listed in § 1.1361-1(j)(6)(ii).

Section 1.1361-1(j)(6)(iii)(A) provides that if S corporation stock is transferred to a trust, the QSST election must be made within the 16-day-and-2-month period beginning on the day that the stock is transferred to the trust.

Section 1.1361-1(j)(6)(iii)(E) provides that if a corporation's S election terminates because of a late QSST election, the corporation may request inadvertent termination relief under § 1362(f).

Section 1.1361-1(j)(7)(i) provides that the income beneficiary who makes the QSST election and is treated (for purposes of § 678(a)) as the owner of that portion of the trust that consists of S corporation stock is treated as the shareholder for purposes of §§ 1361(b)(1), 1366, 1367, and 1368.

Section 1.1362-4(b) provides, in relevant part, that the determination of whether a termination was inadvertent is made by the Commissioner. The corporation has the burden of establishing that under the relevant facts and circumstances the Commissioner should determine that the termination was inadvertent. The fact that the terminating event was not reasonably within the control of the corporation and, in the case of a termination, was not part of a plan to terminate the election, or the fact that the terminating event or circumstance took place without the knowledge of the corporation, notwithstanding its due diligence to safeguard itself against such an event or circumstance, tends to establish that the termination of the election was inadvertent.

Section 1.1362-4(f) provides, in relevant part, that the status of the corporation after the terminating event and before the determination of inadvertence is determined by the Commissioner. Inadvertent termination relief may be granted retroactively for all years for which the terminating event is effective, in which case the corporation is treated as if its election had not terminated.

Section 1.1362-4(d) provides that the Commissioner may require any adjustments that are appropriate. In general, the adjustments required should be consistent with the treatment of the corporation as an S corporation during the period specified by the Commissioner.

CONCLUSION

Based solely on the facts submitted and the representations made, we conclude that X's S corporation election may have been invalid, thus constituting an inadvertent invalid S election effective Date 2. If X's S election was valid, we conclude that X's S election was terminated on Date 3, due to the failure of Trust 5, Trust 6, Trust 7, Trust 8, Trust 9, and Trust 10 to satisfy the requirements of a QSST under § 1361(d)(3)(A)(iv) and to make QSST elections, and on Date 6, due to the failure of Trust 21, Trust 22, Trust 23, and Trust 24 to make timely ESBT elections. We further conclude that if X's S corporation election terminated on Date 3 or Date 6, or as a result of the Trusts' failures to satisfy the QSST requirements of § 1361(d)(3)(B), that the termination was inadvertent within the meaning of § 1362(f). Pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S corporation beginning on and after Date 2, unless X's S corporation election has otherwise terminated under § 1362(d).

This ruling is contingent upon the trustees of the GST Trusts filing elections to treat the GST Trusts as ESBTs effective Date 6 within 120 days from the date of this letter ruling.

Except as specifically ruled upon above, we express or imply no opinion concerning the federal tax consequences of the facts of this case under any other provision of the Code. Specifically, we express or imply no opinion regarding X's eligibility to be an S corporation.

This ruling is directed only to the taxpayer who requested it. According to § 6110(k)(3), this ruling may not be used or cited as precedent.

Pursuant to the power of attorney on file with this office, we are sending a copy of this letter to your authorized representative.

Sincerely,

Faith Colson

Faith Colson
Senior Counsel, Branch 1
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)

Copy of this letter

Copy of this letter for section 6110 purposes

cc: